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FISCAL IMPACT STATEMENT

LS 6224
BILL NUMBER: SB 165

NOTE PREPARED: Mar 20, 2007
BILL AMENDED: Mar 19, 2007

SUBJECT: Income Tax Credits.

FIRST AUTHOR: Sen. Ford
FIRST SPONSOR: Rep. Orentlicher

BILL STATUS: As Passed House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: (Amended) *Community Investment Tax Credit:* The bill establishes a Community Investment Tax Credit against state tax liability for investments that: (1) qualify for a federal New Market Tax Credit; and (2) are made in a community development entity that agrees to reinvest 80% of its total assets in low income community businesses in Indiana.

Venture Capital Investment Tax Credit: The bill provides that a taxpayer is not entitled to a Venture Capital Investment Tax Credit for providing investment capital after December 31, 2012. (Current law provides that a taxpayer is not entitled to a credit for providing investment capital after December 31, 2008.)

Hoosier Business Investment Tax Credit: The bill repeals the expiration date for the Hoosier Business Investment Tax Credit.

Effective Date: (Amended) July 1, 2007; January 1, 2008.

Explanation of State Expenditures: (Revised) *Department of State Revenue (DOR):* The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new Community Investment Tax Credit. The Department's current level of resources should be sufficient to implement this change.

(Revised) *Indiana Economic Development Corporation (IEDC):* The bill requires the IEDC to establish a program for accepting and reviewing applications for certifying Community Development Entities (CDEs) to obtain creditable equity investment; and for certifying equity investment in CDEs as qualified for the Community Investment Tax Credit. In addition, the bill requires certified community development entities to annually report to the IEDC on their programs. The bill requires CDEs to provide the IEDC with the annual report that is filed for federal reporting purposes with the Community Development Financial Institutions Fund. The bill also allows the IEDC to require additional information including: (1) information on state certified investments and federally qualified equity investments made by the entity in Indiana; (2) a description of each eligible business receiving an investment attributable to a state certified investment; (3) an update on the financial status of the eligible businesses; (4) an update on new jobs, increasing wages, total investment, and revenue impact derived from the state certified investment; and (5) the sum of the state credits designated by the certified development entity. The bill requires this report to be submitted to the IEDC and the Legislative Services Agency.

The bill also requires the IEDC to provide an evaluation of the state credit program on a biennial basis. The bill requires the evaluation to include an assessment of: (1) the effectiveness of each certified development entity that receives a state certified investment in creating new jobs and increasing wages in Indiana; and (2) the revenue impact of the certified development entity's state credit program. The IEDC's current level of resources should be sufficient to fulfill these administrative tasks. The March 19, 2007, state position vacancy report indicates that the IEDC has 32 vacant full-time positions.

Explanation of State Revenues: (Revised) *Community Investment Tax Credit:* This bill establishes the Community Investment Tax Credit for equity investment in CDEs that qualify for the federal New Markets Tax Credit (NMTC) and are certified for the tax credit by the IEDC. The amount of credits that could potentially be claimed each year is indeterminable and depends on: (1) the number of CDEs qualifying for the federal NMTC; (2) the creditable investment amount allocated to these CDEs under the NMTC; and (3) the certifications of CDEs and state creditable investment by the IEDC. The credit applies only to qualified equity investment made after December 31, 2007, and can only be claimed beginning in tax year 2008. As a result of these circumstances, any fiscal impact from the credits likely would not arise before FY 2009.

Venture Capital Investment (VCI) Tax Credit: The bill extends the VCI Tax Credit by four years by changing the current expiration date from December 31, 2008, to December 31, 2012. The bill would allow the IEDC to award up to $12.5 M annually in new tax credits for four additional years beginning in 2009. So far, the IEDC has awarded $7.4 M in VCI credits for 2004, $3.4 M in VCI credits for 2005, and $1.9 M in VCI credits for 2006. In addition, 296 individual income taxpayers claimed $2.6 M in VCI credits on 2005 tax returns. The amount of VCI credits claimed in 2005 by corporate income taxpayers is unknown.

Hoosier Business Investment (HBI) Tax Credit: The bill eliminates the sunset date for the HBI Tax Credit. Under current statute, the HBI Tax Credit expires on December 31, 2011. This would allow the IEDC to award new tax credits for qualified investment occurring in 2012 and after. The potential amount of new credits that might be awarded by the IEDC beginning in 2012 and the proportion of these awarded credits that ultimately might be claimed against state tax liability by taxpayers in subsequent years is indeterminable.

The IEDC awarded $331.7 M in new credits in 2004 (the first year of the HBI Tax Credit) and $152.8 M in new credits in 2005. The amount of new credits awarded by the IEDC in 2006 is unavailable at this time. In addition, 53 individual income taxpayers claimed $1.2 M in HBI credits on 2005 tax returns. The amount of HBI credits claimed in 2005 by corporate income taxpayers is unknown.

(Revised) *Background:* Community Investment Tax Credit: The nonrefundable tax credit is equal to 5% of the equity investment in a certified CDE held by a corporate or individual taxpayer, including a pass through entity, that is certified for the credit by the IEDC. The 5% credit applies for seven years beginning with the taxable year in which the investment is certified by the IEDC. Thus, the total credit on the equity investment is equal to 35%. The credit may be taken against the taxpayer's Adjusted Gross Income (AGI) Tax liability, Financial Institutions Tax liability, or Insurance Premiums Tax liability. The only equity investment that qualifies for the state credit is equity investment in a CDE that qualifies for the federal NMTC. The bill requires the IEDC to establish a program to certify CDEs that are qualified to receive the federal NMTC as state certified CDEs. The bill requires the IEDC to certify a federally qualified CDE as a state certified CDE if it:

(1) is qualified to receive equity investment that qualifies for the federal NMTC;

(2) commits in an agreement with the IEDC to continue to loan to or otherwise reinvest in low-income community businesses in Indiana for at least seven years current with the federal credit period; and

(6) commits in an agreement with the IEDC to invest at least 80% of its aggregate gross assets (including reserves) in low-income community businesses.

The bill requires the IEDC to certify a federally qualified equity investment as a state certified investment only if: (1) a certified development entity designates the federally qualified equity investment for a state credit in a manner and on the designation form prescribed by the IEDC; and (2) the certified development entity that designates the qualified equity investment for a state credit is in compliance with the agreements entered into with the IEDC by the certified development entity.

The tax credit is nonrefundable, and unused credit amounts may not be carried back. However, a taxpayer may carry forward any unused credit amount for up to three subsequent taxable years. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. The bill provides that in the event federal NMTCs are disallowed or recaptured by the IRS, the state credits for the same equity investment are terminated only to the extent the state credits are disallowed or recaptured by the IEDC.

Revenue from the AGI Tax on corporations, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund. Since the tax credit is effective beginning in tax year 2008 for certified investment made beginning in 2008, and requires IEDC certification, the fiscal impact likely would not begin before FY 2009.

<u>Federal New Markets Tax Credit</u>: Section 45D of the Internal Revenue Code (IRC) allows the federal New Markets Tax Credit for a taxpayer who holds a qualified equity investment in a community development entity on the credit allowance date. A qualified equity investment means any equity investment in a qualified CDE if: (1) the investment is a cash investment; (2) substantially used by the CDE to make qualified low-income community investments; and (3) such investment is designated for the purposes of this code section by the CDE. The credit allowance date is the date on which the equity investment in the CDE is initially made, and six anniversary dates each year thereafter. For each of those dates the entity receives a federal tax credit for the equity investment. The credit provided to the investor totals 39% of the cost of the investment and is claimed over a 7-year credit allowance period. The credit is equal to 5% annually in the first three years, and 6% annually in the last four years.

A qualified CDE is defined as any domestic corporation or partnership with the primary mission of serving, or providing investment capital for, low-income communities or persons. The CDE must maintain accountability to residents of these low-income communities through representation on any governing board of the entity. These CDEs are also required under the IRC to be certified by the Treasury Secretary.

Since 2002, allocations of creditable investment under the NMTC have been awarded by the U.S. Department of Treasury. These allocations represent the amount of investments that were designated as qualifying for the NMTC. The total allocation for 2007 and 2008 is set at $3.5 billion per year nationwide under Section 45D of the IRC. (Note: The NMTC was extended through 2008 under the federal Tax Relief and Health Care Act of 2006, signed on December 20, 2006.) The table below reports the creditable investment allocations made to CDEs headquartered in Indiana or national CDEs identifying Indiana as a part of its service area where it would principally focus its activities.

	Creditable Investment Allocations for NMTC	
Allocation Year	**Indiana CDEs**	**National CDEs**
2002	$6 M	$313 M
2003-04	$75 M	$15 M
2005	$0	$140 M
2006	$0	$321 M

Venture Capital Investment Tax Credit: The VCI Tax Credit is a nonrefundable tax credit equal to the lesser of: (1) 20% of qualified venture capital investment (debt or equity capital) provided to a qualified Indiana business during a calendar year; or (2) $500,000. The IEDC is responsible for certifying businesses as qualified to receive creditable venture capital investment and for certifying the tax credit amounts to investors in these businesses. The tax credit is allowed for venture capital investment made from January 1, 2004, to December 31, 2008. Under current law, a taxpayer may claim the credit against the State Gross Retail and Use Tax, Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, or Insurance Premiums Tax liability. While the tax credit is nonrefundable, it may be carried forward for up to five years. No carryback of the tax credit is allowed. Total new credits that could be certified by the IEDC for investment in 2004 was limited to $10 M. This annual credit limit was increased to $12.5 M beginning in 2005. A taxpayer must provide the venture capital investment to the qualified company within two years to obtain the tax credits. Unused credits that are carried forward by taxpayers are not counted toward the $12.5 M annual maximum.

Since 2004, 126 businesses have been certified by the IEDC as qualified to receive venture capital investment for which the investors could claim VCI credits. A total of $12.7 M in VCI credits have been awarded to investors by the IEDC. A total of 296 individual income taxpayers claimed $2.6 M in VCI credits on 2005 tax returns. The amount of VCI credits claimed in 2005 by corporate income taxpayers is unknown. The table below outlines the activity in the VCI credit program. Each qualified business proposes an amount of venture capital that it will raise and the IEDC allocates a credit amount to the business based on the proposed investment amount. Once an investor makes venture capital investment in a qualified business, credits allocated to that business are awarded to the investor. The credits can, at that point, be claimed by the investor against state tax liability. While the IEDC has annually allocated an amount of credits to qualified businesses in excess of the annual credit limit, the total credits that could be awarded to and claimed by investors may not exceed the annual credit limit.

	2004	2005	2006
Qualified Businesses	39	38	49
Credits Allocated	$16.0 M	$10.7 M	$13.2 M
Credits Awarded	$7.4 M	$3.4 M	$1.9 M

Hoosier Business Investment (HBI) Tax Credit: Under current statute, the IEDC Board is authorized to award the nonrefundable HBI Tax Credit for expenditures on qualified investment determined to foster job creation and higher wages in Indiana. The IEDC is currently authorized to award the HBI Tax Credit for qualified investment made before January 1, 2012. (Note: The expiration date was extended from December 31, 2007, to December 31, 2011, under P. L. 137-2006.)

The maximum credit that the IEDC may award is 10% of the qualified investment. A taxpayer may claim the credit against the Adjusted Gross Income (AGI) Tax, Insurance Premiums Tax, or Financial Institutions Tax liability. Prior to May 15, 2005, the maximum allowable credit was 30% of qualified investment. However, the 30% credits may be claimed only against the growth in the taxpayer's tax liability over a specified base year tax liability. The base year is either (1) the tax liability in the immediately preceding tax year or (2) the tax liability in the tax year immediately preceding the tax year in which the qualified investment was made by the taxpayer, whichever makes the computed difference larger. The HBI Tax Credit is nonrefundable and may not be carried back. Unused tax credits may be carried over for up to nine years after the year in which the investment is made, unless a shorter carryover period is stipulated by the IEDC Board.

Approximately $331.7 M in new credits under the 30% credit program was awarded in 2004, the first year of the HBI Tax Credit. In 2005, approximately $137.8 M in new credits was awarded under the 30% credit program, and approximately $15.0 M in new credits was awarded under the current 10% credit program. Also, in 2005, the IEDC certified approximately $55.3 M in credits already awarded under the 30% credit program, signifying that the taxpayer had made the agreed upon qualified investment and could claim the certified amount of credits against the taxpayer's tax liability growth. No credits awarded under the 10% credit program were certified in 2005.

A total 53 individual income taxpayers claimed $1.2 M in certified tax credits on 2005 tax returns. The amount claimed by corporate income taxpayers in 2005 is unknown. In addition, the amount of new tax credits awarded by the IEDC in 2006 and the amount of tax credits certified by the IEDC in 2006 is unavailable at this time.

Pertinent Revenue Distributions: Sales Tax revenue is distributed to the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%). Revenue from the Individual AGI Tax is distributed to the state General Fund (86%) and the Property Tax Replacement Fund (14%). Revenue from the Corporate AGI Tax, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Indiana Economic Development Corporation; Department of State Revenue; Legislative Services Agency.

Local Agencies Affected:

Information Sources: Gretchen White, Indiana Economic Development Corporation, (317) 234-3997. Bob Walls, Department of State Revenue, (317) 232-2104. *Hoosier Business Investment Tax Credit Project Status Report, 2004 and 2005*, Indiana Economic Development Corporation. U.S. Department. of the Treasury, Community Development Financial Institutions Fund, http://www.cdfifund.gov/programs/programs.asp?programID=5#2.

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